



● **Board of Directors**
Real Property and Asset Management Committee

7/14/2015 Board Meeting

[revised] **CONFIDENTIAL 8-8**

Subject

Authorize purchase of real property in Riverside and Imperial counties [Conference with real property negotiators; property identified as Imperial County Assessor's Parcel Nos. ~~006-020-048~~; 006-090-008, 009, 010, 011, 012, 013, 029; 006-210-~~008~~, 009, 021, 029; 006-220-013, ~~015, 016, 018~~, 019, ~~020 (pm)~~, 021, 022, 027 (pm), 057, 058 and Riverside County Assessor's Parcel Nos. 815-190-007, 012, 014; 815-200-007, 011; ~~815-210-013~~; 815-302-008; 815-310-013; 815-320-007; 821-100-018, 019; 821-150-018; 821-160-012, 013; 824-200-009, ~~009-9~~, 014-~~3~~, 016-~~5~~, 020, ~~020-8~~; 827-061-004, 005; 827-062-006, 007, 008, 016, 017; 827-071-002; 827-080-004, 008, 010, 027, 028, 029; 827-190-003 through 007, 009, 010, 012; 830-210-009, 010; 830-230-006; 833-030-012; 833-050-007, 008, 010, 012, 014; 833-060-001, 004, 018, 024, 025, 026, 027, 030; 833-100-005, 007, 011, 012, 016, 017; 833-140-005; 833-210-006, 012, 013; 833-220-002, 003; 833-230-001, 002; 833-260-001, 003, 004, 005; 833-270-003, 004, 005; 833-280-002, ~~863-090-013, 014~~; 863-140-002; 863-150-001; 863-170-005, 006; 863-180-003, 004, 005; 863-220-005; 866-040-004, 005, 007, 008; 866-080-001, 002, 003, 005, 012; 866-090-002, 009, 010, 013, 014; 866-130-001, 002, 003, 004; 866-210-006-~~3~~, 010-~~6~~; 866-240-004, 009; 866-250-008, 009, 011; 869-130-001; 869-270-006, 010; 869-291-002, 003, 005, 009; 869-292-001, 002, 003; 872-080-~~006-7~~, 007-~~8~~, 008-~~9~~; 872-090-005-~~7~~, 006-~~8~~, 007-~~9~~, 008-~~0~~; 872-100-001-~~3~~; 872-150-005-~~2~~; 872-160-006-~~4~~, 007-~~5~~, 008-~~6~~, 009-~~7~~; 872-180-006, 009; 872-340-014, 014-7, 018, 018-1; 872-352-003-~~4~~, 010-~~0~~, 017-~~7~~; 872-360-001-~~7~~, 003-~~9~~; 872-370-002-~~9~~, 008-~~5~~, 013-~~9~~, 014-~~0~~, 016-~~2~~, 018-~~4~~; 875-021-001, 002, 006, 007, 008, 013, 014; 875-022-003, 004, 005, 006, 012; 875-030-012, 014, 027, 028; 875-040-006; 875-071-001, 002-~~6~~, 003-~~7~~, 004, 005, 006-~~0~~, 007-~~1~~, 012-~~5~~, 013-~~6~~, 014-~~7~~, 015; 875-131-005-~~4~~, 006-~~5~~, 009-~~8~~, 010-~~8~~; 875-171-001-~~4~~, 002-~~5~~, 018; 875-250-010; 878-020-004, 005, 008; 878-030-009, 016; 878-040-008; 878-050-003, 004, 005, 006, 010, 011, 012, 013; 878-060-002-~~3~~; 878-070-001-~~3~~; 878-081-001, 002, 004, 005; 878-090-001; 878-091-001-~~8~~, 005-~~2~~, 006-~~3~~; 878-092-003, 016, 017, 018; 878-101-004, 005; 878-151-004-~~6~~, 005-~~7~~; 878-152-003-~~8~~, 031-~~3~~; 878-202-003, 005; and 878-240-009, 010, 011, 012; agency negotiators: Jeffrey Kightlinger and John Clairday; negotiating party: Verbena, LLC; under negotiation: price and terms of payment; to be heard in closed session pursuant to Gov. Code Section 54956.8]

Executive Summary

Metropolitan has the opportunity to purchase approximately ~~12,773~~ 12,782.20 acres of land located in the Palo Verde Valley in Riverside and Imperial Counties. These lands are enrolled in the Land Management and Crop Rotation Program that Metropolitan has implemented with Palo Verde Irrigation District, and are subject to Metropolitan's annual fallowing call, which ranges between 1,050 and 4,215 acres for the 25 years remaining of the program term. With the acquisition of this land Metropolitan would eliminate the future fallowing payments for this land, and more importantly achieve greater flexibility in managing the Colorado River water supplies that are available to it under the Law of the Colorado River and the Quantification Settlement Agreement and related agreements. Metropolitan previously acquired 9,704 acres of Palo Verde Valley land in 2001 from San Diego Gas & Electric Company that is leased under terms that allow fallowing and other conservation measures to be implemented. Staff is seeking authority to purchase the land being offered for sale for ~~\$255,461,300~~ \$255,644,000, plus escrow, title insurance, and related costs of closing the transaction.

Details

The Law of the Colorado River

Water rights in the Colorado River are governed by a complex set of statutes, an interstate compact, an international treaty, U. S. Supreme Court decrees, and numerous contracts and regulations, collectively referred to as the Law of the River. California's entitlement in normal years is limited to 4.4 million acre-feet (maf). Pursuant to the 1931 Seven Party Agreement among California water agencies, the first priorities, up to 3.85 maf per year, are assigned to four agricultural water districts – Palo Verde Irrigation District (PVID), Yuma Reclamation Project (Yuma Project), Imperial Irrigation District (IID), and Coachella Valley Water District (CVWD). Metropolitan holds the rights to the next 1.2 maf, providing for a full Colorado River Aqueduct. In its 1963 ruling in *Arizona v. California*, the U. S. Supreme Court held that pre-1928 present perfected rights (e.g., water rights for tribal reservations) must be satisfied before water is delivered to holders of water delivery contracts issued under the 1928 Boulder Canyon Project Act. The present perfected rights are also counted towards California's 4.4 maf entitlement.

Although the Law of the River provides Metropolitan with rights to water sufficient to fill the Colorado River Aqueduct, it also subordinates the delivery of that water to the holders of present perfected rights and senior priority rights. Prior to 2001, Metropolitan's Colorado River orders were filled with surplus water and supplies unused by Arizona and Nevada. Unused water became scarce with operation of the Central Arizona Project in the 1990s, and in 2001, the Secretary of the Interior adopted new guidelines governing when surplus would be made available. To adjust to the reduced supplies, the California agencies negotiated the Quantification Settlement Agreement (QSA) and related agreements.

The QSA establishes limits on the third priority rights held by IID and CVWD at a combined total of 3.43 maf and also assigns to them a portion of the water used to satisfy present perfected rights. The QSA effectively estimated the Priority 1 and 2 usage by PVID and Yuma Project at 0.42 maf (the combined 3.43 and 0.42 amounts equal the agricultural priority total of 3.85 maf). By quantifying IID and CVWD, the QSA allows Metropolitan to take delivery of additional water when PVID and Yuma fall below the 0.42 maf amount. Metropolitan also agreed in the QSA that its deliveries would be reduced by the amount that PVID and Yuma exceed 0.42 maf in any year, and by the amount that present perfected rights exceed 11,400 acre-feet in any year. The QSA protects Metropolitan against over-use of Colorado River water by IID and CVWD, but Metropolitan's water supplies remain contingent on the water used by PVID, the Yuma Project, and Indian Tribes with present perfected rights. For that reason, Metropolitan has taken actions to manage the Colorado River water use in PVID.

Purchase of SDG&E Land

In 2001, Metropolitan purchased 16,344 acres of land from San Diego Gas & Electric Company. The SDG&E held land was intended for use as an electric generating plant that was never constructed, and is comprised of 9,704 acres of Priority 1 lands in the Palo Verde Valley and 6,640 acres of land on the Palo Verde Mesa. Metropolitan's cost to purchase this land in 2001 was \$41.4 million. Metropolitan has leased the Priority 1 lands for agricultural use, on terms that allow for all or any portion of the land to be taken out of production at Metropolitan's election.

PVID Fallowing Program

In 2004, Metropolitan executed an agreement with PVID to implement a fallowing program to reduce the Colorado River water used on Priority 1 lands in the Palo Verde Valley. The program was opened to all owners of Priority 1 lands, including Metropolitan's lands, and a total of 25,947 acres were enrolled. Under the terms of the program, Metropolitan made an initial payment of \$3,170 per acre for each acre that could be fallowed, and makes annual payments for each acre that is fallowed in any given year. The current annual payment amount is \$771 per fallowed acre, with the unit rate increasing over time based on an inflation factor. The total cost of the initial payments was \$73.5 million, and the annual payments have totaled \$113.9 million over the first ten years of the program through 2014.

The program has a term of 35 years, and will conclude in 2040. The initial cap of 26,500 acres represents about 25 percent of the land entitled to Priority 1 Colorado River water. However, Metropolitan and PVID agreed to

increase the fallowed acreage on an emergency basis due to the drought conditions in 2009. Metropolitan paid a higher payment for the additional one-year emergency fallowing, with a total cost of \$21.7 million.

Metropolitan estimated that it would achieve water conservation of 4.2 acre-feet per acre of fallowed land. Calculations by the Bureau of Reclamation indicate that the actual amount of water conserved by fallowing is averaging about 4.8 acre-feet per fallowed acre. Under the terms of the QSA, the conserved water reduces the impacts on Metropolitan's Colorado River supplies from the total amounts used by PVID.

Potential Land Purchases

When Metropolitan implemented the fallowing program in 2005, the largest landowner in the Palo Verde Valley was Farmland Reserve, Inc., a Utah nonprofit corporation, with holdings of about 12,870 acres. Farmland Reserve enrolled its lands in the fallowing program and had a maximum fallowing obligation of 4,220 acres. In 2011, Farmland Reserve sold most of the lands to Verbena LLC, and assigned the fallowing contract to the buyer.

Verbena has made several efforts since acquiring the property to transfer the water used on the Palo Verde lands to water districts in the Central Valley. Verbena proposed to Metropolitan that it would take the land out of production if Metropolitan would agree to exchange the conserved water for State Water Project water supplies to be delivered for use on lands in Antelope Valley East Kern Water Agency, Semitropic Water Storage District, or Westlands Water District. When these proposals were not accepted, Verbena offered to sell its lands, totaling ~~12,773~~ 12,782.20 acres, to Metropolitan for \$20,000/acre. The lands are shown on **Attachment 1**.

Analysis of Potential Land Acquisitions

The Colorado River is one of Metropolitan's two main sources of supply. Under the Law of the River, the volume of Colorado River water available to Metropolitan is affected by the amount of water used in PVID. The need for Metropolitan to have a role in managing PVID's water use is reflected in the significant investments exceeding \$250 million that have already been made through land acquisition and the 35-year fallowing program. The offer to sell Metropolitan the Verbena landholdings provides an opportunity to make a further investment towards the long-term protection of the Colorado River water supply.

Land ownership provides Metropolitan with benefits that cannot be matched through alternative temporary arrangements. While the fallowing program provides water supply benefits, it does so with an ongoing cost in payments to landowners for each year of the program. There are maximum and minimum fallowing limits incorporated in the program terms that prevent Metropolitan from increasing the water supply in years of need, and require ongoing payments in years when there is no need for additional water. When the program terminates in 25 years, Metropolitan will need to negotiate a new set of financial and operational terms in order to maintain the water supply benefit of the program. In contrast, the investment in purchasing property avoids future financial risks, and the ability to lease or sell the property protects Metropolitan against continuing costs in the event that no water supply benefits are needed or achievable through PVID.

Metropolitan is also at risk from outside investors who are willing to pay higher prices for land in PVID to ensure a reliable supply of alfalfa as feed for overseas consumption. Verbena acquired its property in the expectation that it would be able to transfer the water used on the property for use in a different part of California. But there are other investors that would continue to farm the land to the full extent possible to meet demands for the crops grown. A large amount of the alfalfa crop grown in the valley is shipped to Asia. A large parcel of land in PVID has reportedly just been sold to provide a similar reliable feed supply for dairy cattle in Saudi Arabia. Investors that intend to fully and permanently utilize the land for crop production will limit future opportunities for Metropolitan to provide financial incentives for temporary fallowing. Ownership of land avoids that future risk.

Staff has analyzed the future financial risks that would be required to maintain the same level of water supply benefits based on conservative assumptions as to the future costs of temporary fallowing programs in PVID. In addition, the purchase of the lands offered by Verbena would avoid the fallowing payments that would be due for the remaining 25 years of the existing program. The combined avoided costs and future financial risks support an investment in the range of \$15,000 to \$21,000/acre to acquire Priority 1 land. Based on the permanent benefits provided through land ownership, the risks to Metropolitan's Colorado River water supplies from outside investors acquiring land, and the financial risk arising from future fallowing program negotiations, staff

recommends that the General Manager be authorized to accept the offer to purchase the Verbena land. The total cost of the purchase, including costs of escrow, title insurance, and other professional, technical, and staff work would be approximately \$264,000,000 (**Attachment 2**). The purchase agreement provides for an initial \$1.25 - million dollar "inducement" payment deposit into escrow. Under the terms of the agreement, Verbena would be entitled to retain the deposit in the event that Metropolitan refused to complete the purchase following board approval. In the event that the transaction was not completed due to Verbena's failure to perform, or to third party actions, the full "inducement" deposit would be returned to Metropolitan. The purchase would be funded from the Replacement and Refurbishment Fund and the Water Rate Stabilization Fund.

Policy

Metropolitan Water District Administrative Code Section 8201: Acquisition of Real Property

California Environmental Quality Act (CEQA)

CEQA determination for Option #1:

Pursuant to the provisions of CEQA and the State CEQA Guidelines, a Final Environmental Impact Report (Final EIR) and Findings of Fact for the Palo Verde Irrigation District Land Management, Crop Rotation, and Water Supply Program (Program) were prepared and certified by PVID as the lead agency. The Verbena, LLC property is enrolled in the Program and following of that property pursuant to the Program is covered by the Final EIR for the Program. Accordingly, no further CEQA documentation is necessary for the ongoing use of the property in accordance with the Program.

The purchase of the Verbena, LLC land by Metropolitan qualifies for a Class 25 categorical exemption from the provisions of CEQA because the property will allow continued agricultural use of lands and preserve open space uses (Section 15325, State CEQA Guidelines).

The CEQA determination is: Determine that the purchase of land from Verbena, LLC qualifies for a categorical exemption (Class 25) and is otherwise not subject to CEQA under the general rule that CEQA applies only to projects with the potential for causing significant effects pursuant to Sections 15325 and 15061(b)(3) of the State CEQA Guidelines.

CEQA determination for Option #2:

None required

Board Options

Option #1

Adopt the CEQA determination that the action is categorically exempt and is not subject to CEQA, and

- a. Authorize the General Manager to purchase the Verbena land in the Palo Verde Valley at a price not to exceed ~~\$255,461,300~~ \$255,644,000, plus the incidental related cost of closing the purchase transaction; and
- b. Appropriate up to \$264,000,000 to complete the transaction, including the purchase price, escrow, title insurance, and related labor and incidental costs.

Fiscal Impact: Approximately \$264,000,000 in funds available in the Replacement and Refurbishment Fund and the Water Rate Stabilization Fund.

Business Analysis: Metropolitan's Colorado River water supplies are subject to increase or decrease based on the water use in PVID. Metropolitan has committed significant investments in managing water use in PVID, and the purchase of additional lands provides permanent benefits and avoids future financial risks that could result in even greater future costs.

Option #2


Do not purchase the lands on the terms offered; but continue to monitor the real estate market in PVID to take advantage of any future opportunities at lower cost.

Fiscal Impact: No immediate financial impact

Business Analysis: Metropolitan has an ongoing financial risk that the costs of managing the water use in PVID will increase over time. Failure to complete the purchase of the offered lands will not reduce or eliminate that risk.

Staff Recommendation

Option #1


John Clairday
Manager, Real Property Development and
Management

7-10-2015
Date

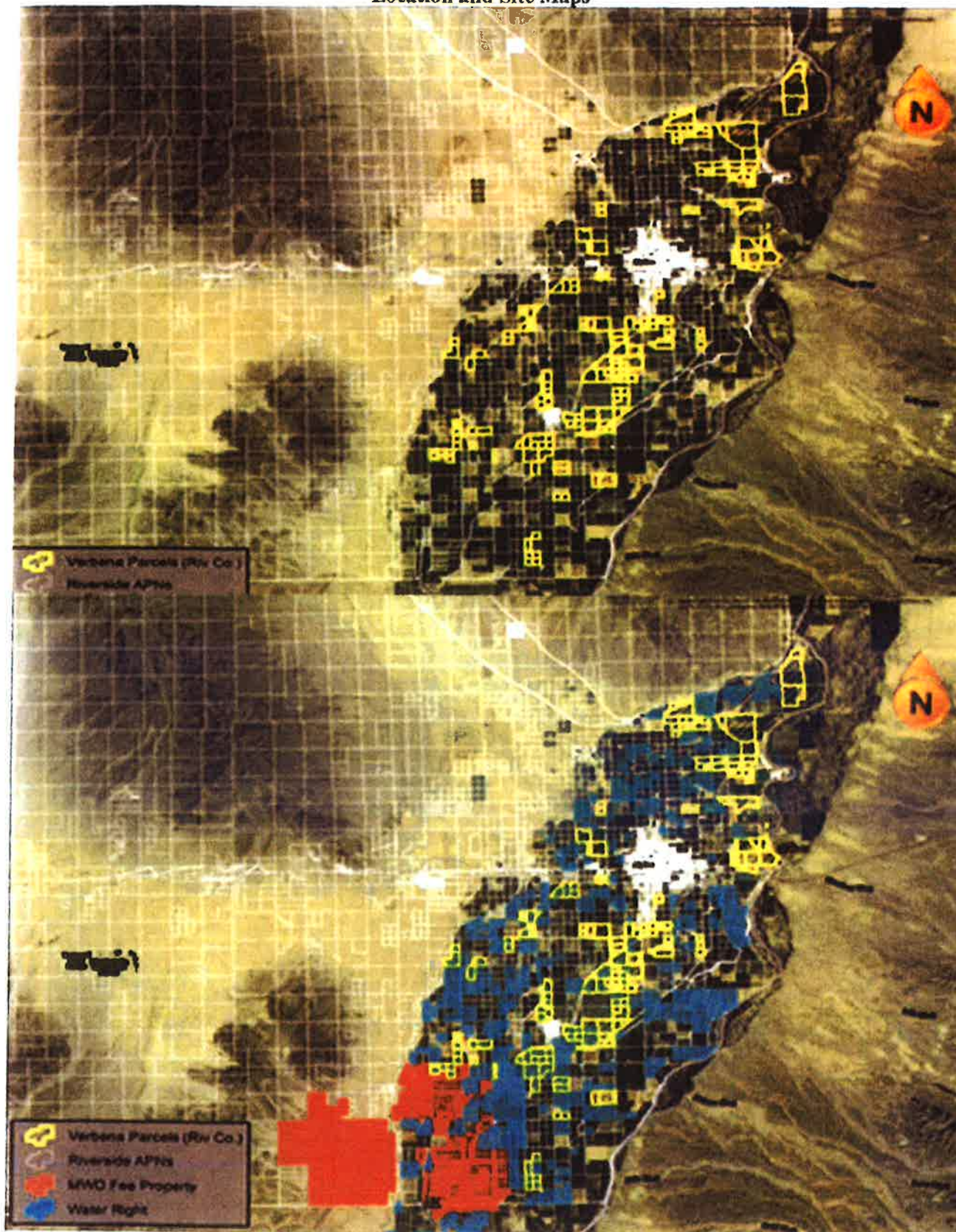

Jeffrey Kightlinger
General Manager

7/10/15
Date

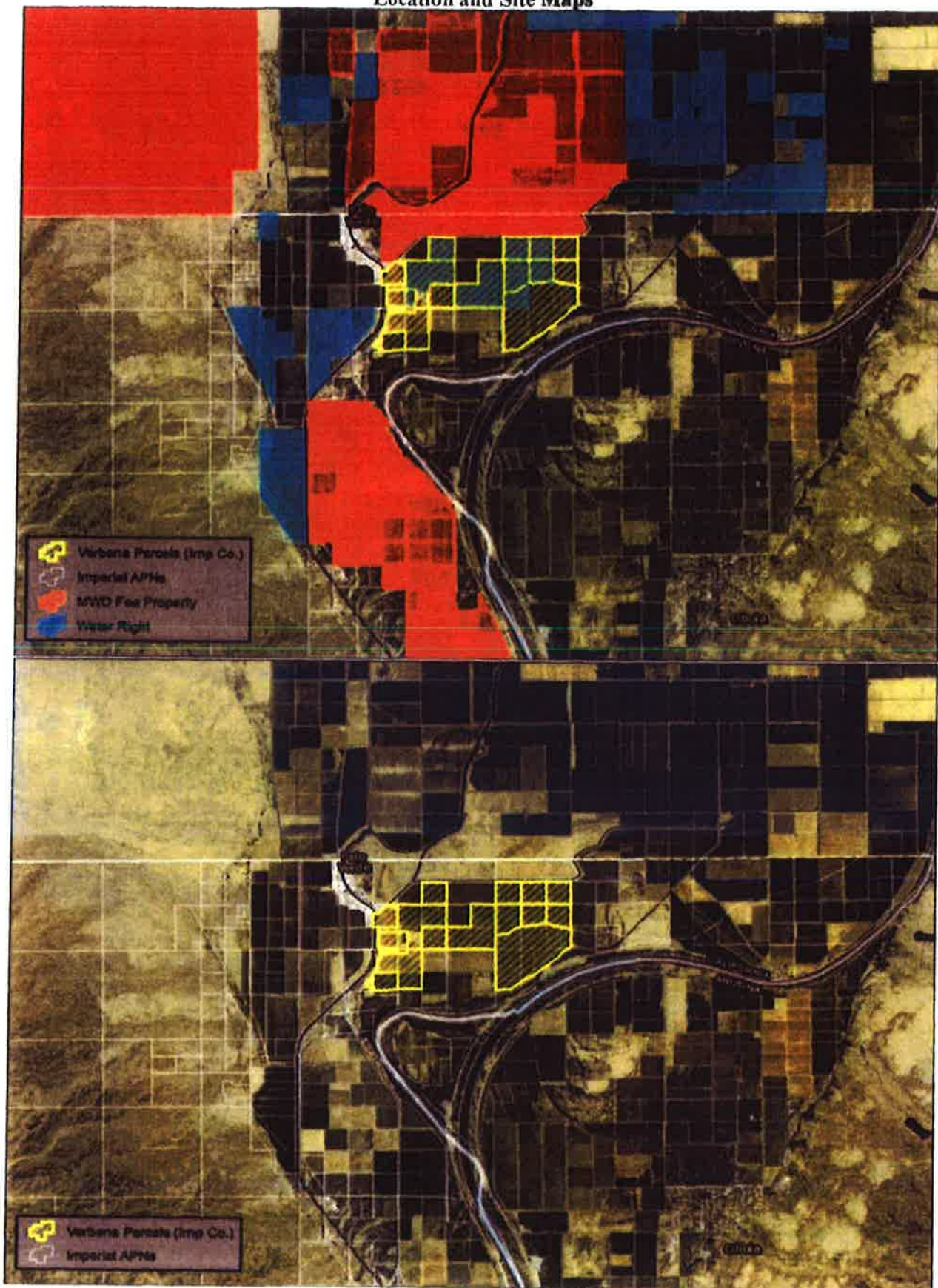
Attachment 1 – Location and Site Maps

Attachment 2 – Financial Statement

Location and Site Maps



Location and Site Maps



Verbena Acquisition Budget

Breakdown of this action is as follows:

**Current Board
Action No. 1
(July 2015)**

Labor

Studies and Property Investigations	83,200
Transaction Oversight/Document Development	
Real Property Research/Support	
PTR Coordination/PTR Review	
Preparation of Land Descriptions	
Preparation of Exhibit Maps	
Phase 1 Coordination/Oversight	

Professional/Technical (P&T)

Orange Coast Title Company	120,000
Title Reports	
Escrow Services	
Policy of Title Insurance	
Ninyo & Moore Engineering/Environmental	10,000
SLR Phase 1 Report Review/Analysis	
Mapping Contracts	
R/W Mapping	170,000
Records of Survey	7,500,000

Remaining Budget 79,000

Land Cost (Verbena) 255,644,000

Total \$ 263,606,200

\$ 264,000,000 (Rounded)

Funding Request

Program Name:	Verbena Property Acquisition		
Source of Funds:	Replacement and Refurbishment Fund and the Water Rate Stabilization Fund		
Appropriation No.:	TBD	Board Action No.:	1
Requested Amount:	\$ 264,000,000	Capital Program No.:	N/A
Total Appropriated Amount:	\$ 264,000,000	Capital Program Page No.:	N/A